Financial Highlights

Performance Results	Year Ended December 31, 2017	2016	2015	2014	2013
Return on average equity	10.56%	10.70%	11.24%	11.79%	11.52%
Return on average assets	1.23%	1.24%	1.25%	1.21%	1.14%
Equity to assets	11.90%	11.41%	11.24%	10.73%	9.81%
Earnings per share - Basic	$4.49	$4.29	$4.12	$3.90	$3.52
Dividends per share	$1.08	$0.98	$0.90	$0.79	$0.76
Book value per share	$43.90	$40.50	$38.08	$35.02	$31.13
Market value per share	$58.00	$47.25	$38.42	$35.25	$29.50
Average earning assets to average total assets	95.97%	96.85%	97.63%	97.09%	97.44%
Allowance for credit losses to total loans at December 31	1.19%	1.28%	1.49%	1.60%	1.58%
Net overhead to average assets	1.23%	1.28%	1.20%	1.14%	1.00%
Yield and Cost of Funds					
Tax equivalent yield on investments	2.91%	2.65%	2.58%	2.73%	1.93%
Tax equivalent yield on loans	4.05%	4.09%	4.23%	4.47%	4.91%
Cost of funds	0.35%	0.36%	0.39%	0.53%	0.67%
Tax equivalent net interest margin	3.27%	3.25%	3.28%	3.27%	3.03%
Selected Items ***(in thousands)***					
Total cash and cash equivalents	$56,686	$125,444	$81,315	$54,205	$64,645
Total investments	$518,456	$417,677	$409,762	$475,353	$465,205
Total loans	$894,250	$872,054	$855,351	$762,273	$720,861
Total assets	$1,516,014	$1,454,239	$1,381,663	$1,324,604	$1,283,278
Total deposits	$1,314,302	$1,269,026	$1,203,816	$1,159,306	$1,137,897
Total equity	$180,458	$165,879	$155,343	$142,069	$125,917

To the Shareholders and Friends of Cashmere Valley Bank

In 2017 we celebrated our 85th year in business. This past year saw profit rise by 5.04% to $18,408,000 or $4.49 per share up from $4.29 a share in 2016. Asset growth was modest at 4.25% with deposit growth coming in at 3.57%. These growth rates are below our goal. However we don't grow just for growth sake. We have also increased our focus on market expansion to increase these rates in the future.

With these modest growth rates and continued excellent profitability, our capital continues to rise as a percentage of assets. This insulates the institution from risk but also make returns on that capital harder to achieve. With that, we were proud to declare a special dividend of $1.50 per share in February of 2018. We have also began moving forward with expansion plans in Yakima with the opening of a new branch in the downtown area on February 1, 2018. We have retained our original branch in Summitview so we now have 2 branches in Yakima. And, for the first time, have begun a full out marketing effort now that we have the facilities to properly service what we hope to be an expanding market share in Yakima County.

I am also proud to announce that Mitchell, Reed and Schmitten insurance completed two acquisitions in 2017. Starting with Gellatly Agency, a 100 year old name in the insurance business in Wenatchee. We have also purchased the Elliott Agency in Yakima. It is the oldest Pemco agency in the State of Washington and brings a highly regarded name to the CVB family. This name recognition allow us to more easily introduce Cashmere Valley Bank to new households in Yakima. We believe these efforts will improve our growth rates and begin to deploy our excess capital to provide continued excellent returns for our shareholders.

Loan quality continues to be very good. No doubt helped by an improving unemployment rate and an expanding economy. All positive conditions for banking

Capital markets are also very friendly to banking these days. With continued expectations of regulatory relief, reduced federal income taxes and gently rising interest rates, our stock has done very well this past year. Our stock price increased 22.7% plus dividends by year end. And since year end it is up another 13% (as of this writing) in 2018. I wish I could tell you it was caused by brilliant management. While we are a very consistent performer, I'm afraid it's simply a case of demand for our stock and the market participants putting a higher value on our company. That's all well and good as long as you keep in mind that the market can change its mind at any time and frequently does. In the meantime, we continue to keep our eye on the ball, seeking to achieve fundamental improvement in our operation and growth in our market coverage. Our goal is to achieve all of this at our traditional low risk profile while continuing to be *"the little bank with the big circle of friends"*.

If you have any questions or would just like to talk about your bank, please feel free to contact me at 509-782-2092.

Sincerely,

Greg Oakes,
President and CEO

BDO

Tel: 509-747-8095
Fax: 509-747-0415
www.bdo.com

601 W. Riverside Ave., Suite 900
Spokane, WA 99201-0611

Independent Auditor's Report

Management & Audit Committee
Cashmere Valley Bank
Cashmere, Washington

We have audited the accompanying consolidated financial statements of Cashmere Valley Bank, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income and comprehensive income, shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement,

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Cashmere Valley Bank as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BDO USA, LLP

Spokane, Washington
March 14, 2018

Cashmere Valley Bank and Subsidiary
Consolidated Balance Sheets

(Dollars in Thousands, Except Share Amounts)

	December 31, 2017	December 31, 2016
Assets		
Cash and cash equivalents:		
Cash and due from banks	$25,401	$19,516
Interest-bearing deposits at other financial institutions	27,065	95,337
Federal funds sold	4,220	10,591
Total cash and cash equivalents	56,686	125,444
Securities available for sale at fair value	514,848	414,131
Securities held to maturity (fair value of $1,523 and $1,533)	1,539	1,551
Federal Home Loan Bank (FHLB) stock, at cost	1,831	1,757
Pacific Coast Banker's Bancshares (PCBB) stock, at cost	238	238
Loans held for sale	1,171	397
Loans and leases	894,250	872,054
Allowance for credit losses	(10,639)	(11,037)
Net loans and leases	883,611	861,017
Premises and equipment, net	16,834	14,250
Accrued interest receivable	5,578	4,504
Foreclosed real estate	-	66
Bank Owned Life Insurance (BOLI)	14,582	14,118
Goodwill	7,162	6,820
Intangibles, net	2,557	4
Mortgage servicing rights	1,696	1,723
Other assets	7,681	8,219
Total assets	**$1,516,014**	**$1,454,239**
Liabilities		
Deposits:		
Noninterest-bearing demand	$218,418	$199,633
Savings and interest-bearing demand	862,484	830,310
Time	233,400	239,083
Total deposits	1,314,302	1,269,026
Accrued interest payable	454	445
Short-term borrowings	9,742	11,752
Long-term borrowings	1,815	2,119
Other liabilities	9,243	5,018
Total liabilities	**1,335,556**	**1,288,360**
Commitments and contingencies (Note 13)		
Shareholders' Equity		
Common stock (no par value); authorized 10,000,000 shares; Issued and outstanding: 2017 – 4,110,845 ; 2016 – 4,095,966	--	--
Additional paid-in capital	2,507	1,962
Retained earnings	175,474	161,939
Accumulated other comprehensive income	2,477	1,978
Total shareholders' equity	**180,458**	**165,879**
Total liabilities and shareholders' equity	**$1,516,014**	**$1,454,239**

The accompanying notes are an integral part of these financial statements.

(Dollars in Thousands, Except Per Share Amounts)	Year Ended December 31,	
	2017	**2016**
Interest Income:		
Loans and leases	$33,051	$33,282
Federal funds sold and deposits at other financial institutions	761	191
Securities available for sale:		
Taxable	5,550	5,605
Tax-exempt	6,540	4,738
Securities held to maturity – tax-exempt	30	36
Total interest income	45,932	43,852
Interest Expense:		
Deposits	4,438	4,296
Short-term borrowings	21	28
Long-term borrowings	133	151
Total interest expense	4,592	4,475
Net interest income	**41,340**	**39,377**
Recovery for credit losses	-	(735)
Net interest income after provision for credit losses	**41,340**	**40,112**
Noninterest Income:		
Service charges on deposit accounts	1,366	1,127
Mortgage banking operations	2,623	2,360
Net gain/(loss) on sales of securities available for sale	439	(1,925)
Brokerage commissions	664	518
Insurance commissions and fees	1,669	1,833
Net interchange income	1,509	1,716
Increase in surrender value of BOLI	464	492
Other	1,546	1,538
Total noninterest income	10,280	7,659
Noninterest Expense:		
Salaries and employee benefits	14,678	14,011
Occupancy and equipment	5,140	4,155
Audits and examinations	791	431
State and local business and occupation taxes	600	615
FDIC insurance & WA state assessments	466	828
Legal and professional fees	453	439
Net (gain) on foreclosed real estate	(3)	(26)
Check losses and charge-offs	354	252
Low income housing fund losses	363	341
Data processing	1,205	775
Product delivery	1,268	1,231
Other	3,374	2,642
Total noninterest expense	28,689	25,694
Income before income taxes	**22,931**	**22,077**
Income Taxes	4,523	4,553
Net income	**$18,408**	**$17,524**
Change in the fair value of securities available for sale, net of tax	60	(3,468)
Comprehensive income, net of tax	**$18,468**	**$14,056**
Earnings per common share – Basic	$4.49	$4.29
Earnings per common share – Diluted	$4.47	$4.27

The accompanying notes are an integral part of these financial statements.

Cashmere Valley Bank and Subsidiary
Consolidated Statements of Shareholders' Equity

(Dollars in Thousands, Except Share Information)

	Shares of Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity
Balance as of December 31, 2015	**4,079,179**	**$1,472**	**$148,425**	**$5,446**	**$155,343**
Net income	--	--	17,524	--	17,524
Other comprehensive income (loss), net of tax	--	--	--	(3,468)	(3,468)
Disqualifying disposition tax benefit	--	10	--	--	10
Cash dividends paid ($0.48 per share—January, $0.50 per share—July)	--	--	(4,004)	--	(4,004)
Stock based compensation expense	--	128	--	--	128
Exercise of common stock options	12,977	352	--	--	352
Restricted stock grants	4,050	--	--	--	--
Restricted stock forfeitures	(90)	--	--	--	--
Shares repurchased	(150)	--	(6)	--	(6)
Balance as of December 31, 2016	**4,095,966**	**$1,962**	**$161,939**	**$1,978**	**$165,879**
Net income	--	--	18,408	--	18,408
Other comprehensive income (loss), net of tax	--	--	--	60	60
Tax rate effect reclassification	--	--	(439)	439	--
Cash dividends paid ($0.53 per share—January, $0.55 per share—July)	--	--	(4,434)	--	(4,434)
Stock based compensation expense	--	247	--	--	247
Exercise of common stock options	11,689	298	--	--	298
Restricted stock grants	3,750	--	--	--	--
Restricted stock forfeitures	(560)	--	--	--	--
Balance as of December 31, 2017	**4,110,845**	**$2,507**	**$175,474**	**$2,477**	**$180,458**

The accompanying notes are an integral part of these financial statements.

(Dollars in Thousands)

	Year Ended December 31, 2017	2016
Cash Flows from Operating Activities		
Net income	$18,408	$17,524
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,151	1,755
Recovery for credit losses	--	(735)
Investment amortization – net	7,401	7,602
Stock based compensation	247	128
Net (gain)/loss on sale of securities, loans, property and equipment	(2,040)	478
Gain on sale and impairment of foreclosed real estate	(3)	(26)
Increase in surrender value of BOLI	(464)	(491)
Originations of loans held for sale	(60,727)	(68,074)
Proceeds from sales of loans held for sale	61,649	69,740
Net change in:		
Accrued interest receivable	(1,074)	(110)
Accrued interest payable	9	38
Deferred income tax	(50)	643
Federal income tax payable	1,238	(1,344)
Deferred compensation	157	398
Increase in deferred income on insurance contracts	1,285	--
Other – net	182	(213)
Net cash provided by operating activities	**28,369**	**27,313**
Cash Flows from Investing Activities		
Activity in securities available for sale:		
Proceeds	46,257	69,444
Maturities, prepayments, and calls	58,644	73,003
Purchases	(212,561)	(166,367)
Activity in securities held to maturity:		
Maturities, prepayments, and calls	21	20
Purchases	--	(497)
Proceeds from redemption of FHLB stock	11	841
Loans and leases originated in excess of principal collected	(23,202)	(19,242)
Investment in low income housing fund	(20)	(25)
Additions to premises and equipment	(4,656)	(2,273)
Proceeds from sale of office property and equipment	47	--
Proceeds from sale of other real estate owned	587	1,351
Net cash paid for acquisitions	(1,080)	--
Net cash used by investing activities	**(135,952)**	**(43,745)**
Cash Flows from Financing Activities		
Net increase in deposits	45,276	65,210
Net decrease in short-term borrowings	(2,030)	(734)
Repayments of long-term borrowings	(285)	(267)
Tax benefits related to stock based compensation	--	10
Cash dividends paid	(4,434)	(4,004)
Exercise of stock options	298	352
Repurchase of common stock	--	(6)
Net cash provided by financing activities	**38,825**	**60,561**
Net change in cash and due from banks	**(68,758)**	**44,129**
Cash and due from banks at beginning of year	125,444	81,315
Cash and due from banks at end of year	**$56,686**	**$125,444**

The accompanying notes are an integral part of these financial statements.

Note 1 – Summary of Significant Accounting Policies

Cashmere Valley Bank (the Company) is a Washington State chartered bank established in 1932 and operates ten branches in North Central Washington. The Company's lending and other banking activities are carried out in and around Chelan, Douglas, Kittitas, and Yakima counties and to a lesser degree, other areas of Western Washington. The Company provides loan and deposit services to customers, who are predominately small and middle-market businesses and middle income individuals. The consolidated financial statements of the Company include the accounts of the Company and the Bank's wholly owned subsidiary, Mitchell, Reed and Schmitten, Inc. (MRS), an insurance agency. Intercompany transactions and balances have been eliminated. MRS is based in Wenatchee, Washington and brokers personal and commercial lines of insurance, including property, casualty, life and health insurance.

Consolidated Financial Statement Presentation

The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) and practices within the financial services industry. GAAP defines a public company as one whose securities trade in a public market, including in over-the-counter markets. As the Company's stock trades in certain over-the-counter markets, certain disclosures are required to meet public company requirements. The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, as of the date of the consolidated balance sheet, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate primarily to the determination of the allowance for credit losses and valuations of securities, goodwill, and mortgage servicing rights. Certain prior year amounts have been reclassified to conform to 2017 presentation, with no change to total shareholders' equity or net income reported.

Cash and Cash Equivalents

The Company considers federal funds sold, cash and amounts due from banks, and interest-bearing deposits at other financial institutions to be cash and cash equivalents, and are reported as such on the consolidated balance sheets and statement of cash flows. Cash flows from loans, deposits, and short-term borrowings are reported net. Additional cash flow information was as follows (dollars in thousands):

	Year Ended December 31,	
	2017	**2016**
Cash paid for interest	$5,491	$5,331
Cash paid for income taxes	3,335	4,944
Significant non-cash transactions:		
Foreclosed real estate acquired in settlement of loans	$(31)	$(122)
Fair value adjustment of securities available for sale, net of tax	(60)	3,468

Stock Based Compensation

The Company has stock based compensation plans which are more fully discussed in Note 15. Under the plans, certain key employees have been awarded restricted stock grants and options to purchase common stock. Under the accounting guidance for stock compensation, compensation expense recognized includes the cost of stock based awards associated with restricted stock grants and incentive stock options (ISOs) which are recognized as compensation expense over the vesting period on a straight-line basis. The Company recognized stock based compensation expense totaling $247,000 and $128,000 in 2017 and 2016, respectively.

Securities Available for Sale

Securities available for sale consist of debt securities that the Company intends to hold for an indefinite period, but not necessarily to maturity. Such securities may be sold to implement the Company's asset/liability management strategies and in response to changes in interest rates and similar factors. Securities available for sale are reported at fair value. Unrealized gains and losses, net of the related deferred tax effect, are reported as a net amount in a separate component of shareholders' equity entitled "accumulated other comprehensive income." Realized gains and losses on securities available for sale, determined using the specific identification method, are included in earnings. Generally, amortization of premiums and accretion of discounts are recognized in interest income over the contractual life of the security using the effective interest method. As principal repayments are received on securities, a proportionate amount of the related premium or discount is recognized so that the effective interest rate on the remaining portion of the security continues unchanged.

The Company evaluates the portfolio for impairment each quarter. In estimating other-than-temporary losses, the Company considers the following factors: (1) the length of time and the extent to which the market value has been less than cost; (2) the financial condition and near-term prospect of the issuer; (3) the intent and ability of the Company to retain its investment in a security for a period of time sufficient to allow for any anticipated recovery in market value; (4) whether it is more likely than not that the Company will be required to sell the securities before recovery; and (5) general market conditions which reflect prospects for the economy as a whole, including interest rates and sector credit spreads. If a loss is deemed to be other-than-temporary, the Company then calculates a credit loss charge against earnings by subtracting the estimated present value of estimated future cash flows on the security from its amortized cost. The other-than-temporary impairment less the credit loss charge against earnings is a component of other comprehensive income.

Securities Held to Maturity

Debt securities which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized in interest income over the period to maturity.

Federal Home Loan Bank Stock

The Company, as a member of the Federal Home Loan Bank (FHLB) system, is required to maintain an investment in capital stock of the FHLB based on the sum of the two following calculations (calculated at least annually as of the preceding December 31):

- The Membership Stock Purchase Requirement: based on a percentage of assets as shown in table below:

	Current Requirement	Minimum Investment	Maximum Investment
Percent of Total Assets	0.12%	0.05%	0.25%
Membership Stock Cap	$10 million	$1 million	$30 million
Membership Stock Floor	$10,000	$10,000	$30,000

- The Activity Based Stock Purchase Requirement: based on a percentage of the book value held and records of the transactions shown in the table below:

Transaction	Current Requirement	Minimum Requirement	Maximum Requirement
Outstanding Advances	4.00%	2.00%	5.00%
Outstanding Acquired Member Assets	4.00%	0.00%	5.00%
Standby Letters of Credit	0.00%	0.00%	0.175%
Advance Commitments	0.00%	0.00%	0.35%
Acquired Member Asset Commitments	0.00%	0.00%	0.60%

The recorded amount of FHLB stock equals its fair value because the shares can only be redeemed by the FHLB at the $100 per share par value.

The Company views its investment in the FHLB stock as a long-term investment. Accordingly, when evaluating for impairment, the value is determined based on the ultimate recovery of the par value rather than recognizing temporary declines in value. The determination of whether a decline affects the ultimate recovery is influenced by criteria such as: (1) the significance of the decline in net assets of the FHLB as compared to the capital stock amount and length of time a decline has persisted; (2) impact of legislative and regulatory changes on the FHLB; and (3) the liquidity position of the FHLB. Management has determined there is no impairment on its FHLB stock as of December 31, 2017.

Loans Held for Sale

Loans originated for sale in the secondary market, which is our principal market, or as whole loan sales are classified as loans held for sale. Management has elected the lower of cost or market option for all single family loans held for sale (originated with the intent to be held for sale) and records these loans at the lower of cost or market. The fair value of loans held for sale is generally based on observable market prices from other loans in the secondary market that have similar collateral, credit, and interest rate characteristics. If quoted market prices are not readily available, the Company may consider other observable market data such as dealer quotes for similar loans or forward sale commitments. In certain cases, the fair value may be based on a discounted cash flow model. Gains and losses on loans held for sale are recognized in net gain on mortgage loan origination and sale activities within noninterest income. Direct loan origination costs and fees for single family loans originated as held for sale are recognized in earnings.

Loans Held for Investment

Loans held for investment are reported at the principal amount outstanding, net of cumulative charge-offs, interest applied to principal (for loans accounted for using the cost recovery method), unamortized net deferred loan origination fees and costs, and unamortized premiums or discounts on purchased loans. Deferred fees and costs and premiums and discounts are amortized over the contractual terms of the underlying loans using the constant effective yield (the interest method). Interest on loans is accrued and recognized as interest income at the contractual rate of interest. A determination is made as of the loan commitment date as to whether a loan will be held for sale or held for investment. This determination is based primarily on the type of loan or loan program and its related profitability characteristics.

When a loan is designated as held for investment, the intent is to hold these loans until maturity or pay-off. If subsequent changes occur, the Company may change its intent to hold these loans. Once a determination has been made to sell such loans, they are immediately transferred to loans held for sale and carried at the lower of cost or fair value.

Direct financing leases are carried at the aggregate of lease payments plus estimated residual value of the leased property less unearned income. Interest income from direct financing leases is recognized over the term of the lease to achieve a constant periodic rate of return on the outstanding investment.

From time to time, the Company will originate loans to facilitate the sale of other real estate owned without a sufficient down payment from the borrower. Such loans are accounted for using the installment method and any gain on sale is deferred.

Nonaccrual Loans

Loans are placed on nonaccrual status when the full and timely collection of principal and interest is doubtful, generally when the loan becomes 90 days or more past due for principal or interest payment, or if part of the principal balance has been charged off.

All payments received on nonaccrual loans are accounted for using the cost recovery method. Under the cost recovery method, all cash collected is applied to first reduce the principal balance. A loan may be returned to accrual status if all delinquent principal and interest payments are brought current and the collectability of the remaining principal and interest payments in accordance with the loan agreement is reasonably assured. Loans that are well-secured and in the process of collection are maintained on accrual status, even if they are 90 days or more past due.

Impaired Loans

A loan is considered impaired when it is probable that all contractual principal and interest payments due will not be collected in accordance with the terms of the loan agreement. Factors considered by management in determining whether a loan is impaired include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due.

Troubled Debt Restructurings

A loan is accounted for and reported as a troubled debt restructuring (TDR) when, for economic or legal reasons, we grant a concession to a borrower experiencing financial difficulty. A restructuring that results in only an insignificant delay in payment is not considered a concession. A delay may be considered insignificant if the payments subject to the delay are insignificant relative to the unpaid principal or collateral value and the contractual amount due, or the delay in timing of the restructured payment period is insignificant relative to the frequency of payments, the debt's original contractual maturity, or original expected duration.

TDRs are designated as impaired because interest and principal payments will not be received in accordance with original contract terms. TDRs that are performing and on accrual status as of the date of the modification remain on accrual status. TDRs that are nonperforming as of the date of modification generally remain as nonaccrual until the prospect of future payments in accordance with the modified loan agreement is reasonably assured, generally demonstrated when the borrower maintains compliance with the restructured terms for a predetermined period, normally at least six months. TDRs with temporary below-market concessions remain designated as a TDR and impaired regardless of the accrual or performance status until the loan is paid off. However, if the TDR loan has been modified in a subsequent restructure with market terms and the borrower is not currently experiencing financial difficulty, then the loan may have its TDR designation removed.

Allowance for Credit Losses

The allowance for credit losses is maintained at a level sufficient to provide for probable credit losses based on evaluating known and inherent risks in the loan and lease portfolio. The allowance is provided based upon management's continuing analysis of the pertinent factors underlying the quality of the loan and lease portfolio. These factors include changes in the size and composition of the loan and lease portfolio, delinquency levels, actual loan loss experience, current economic conditions, and detailed analysis of individual loans for which full collectability may not be assured. The detailed analysis includes techniques to estimate the fair value of loan collateral and the existence of potential alternative sources of repayment. The allowance consists of specific, general, and unallocated components. For such loans that are classified as impaired, a specific allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover the risk of loss due to general economic uncertainties that could affect the loan portfolio and management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. The appropriateness of the allowance for credit losses is estimated based upon these factors and trends identified by management at the time consolidated financial statements are prepared.

When available information confirms that specific loans or portions thereof are uncollectible, identified amounts are charged against the allowance for credit losses. The existence of some or all of the following criteria will generally confirm that a loss has been incurred: the loan is significantly delinquent and the borrower has not demonstrated the ability or intent to bring the loan current; the Company has no recourse to the borrower, or if it does, the borrower has insufficient assets to pay the debt; the estimated fair value of the loan collateral is significantly below the current loan balance, and there is little or no near-term prospect for improvement.

A provision for credit losses is charged against income and added to the allowance for credit losses based on regular assessments of the loan and lease portfolio. The allowance for credit losses is allocated to certain loan and lease categories based on the relative risk characteristics, asset classifications and actual loss experience of the loan and lease portfolio. While management has allocated the allowance for credit losses to various loan and lease portfolio segments, the allowance is general in nature and is available for the loan and lease portfolio in its entirety.

The ultimate recovery of all loans and leases is susceptible to future market factors beyond the Company's control. These factors may result in losses or recoveries differing significantly from those provided in the consolidated financial statements. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for credit losses and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation, which is computed on the straight-line method over the estimated useful lives of the assets, which range from 35 to 40 years for buildings and 3 to 15 years for furniture, fixtures, and equipment. These assets are reviewed for impairment under FASB ASC 360, *"Property, Plant, and Equipment"* when events indicate that the carrying amount may not be recoverable. Gains or losses on dispositions are reflected in earnings.

Foreclosed Real Estate

Real estate properties acquired through, or in lieu of, foreclosure are to be sold and are initially recorded at the fair value of the properties, less estimated costs of disposal, which becomes the new cost basis. Any write-down to fair value at the time of transfer to foreclosed real estate is charged to the allowance for credit losses. Properties are evaluated regularly to ensure that the recorded amounts are supported by their current fair values. Any subsequent reductions in carrying values and revenue and expense from the operations of properties are recognized in the consolidated statement of income.

Mortgage Servicing Rights

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of loans. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Capitalized servicing rights are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

MSRs are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Subsequent fair value measurements of single family MSRs, which are not traded in an active market with readily observable market prices, are determined by considering the present value of estimated future net servicing cash flows. Changes in the fair value of single family MSRs result from changes in (1) model inputs and assumptions and (2) modeled amortization, representing the collection and realization of expected cash flows and curtailments over time. The significant model inputs used to measure the fair value of single family MSRs include assumptions regarding market interest rates, projected prepayment speeds, discount rates, estimated costs of servicing and other income and additional expenses associated with the collection of delinquent loans. Impairment is recognized through a valuation allowance to the extent that fair value is less than the recorded value. If the Company later determines that all or a portion of the impairment no longer exists, a reduction of the allowance will be recorded as an increase to income.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned. The amortization of MSRs is netted against loan servicing fee income.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Company; (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Income Taxes

Deferred tax assets and liabilities result from differences between the consolidated financial statement carrying amounts and the tax basis of assets and liabilities, and are reflected at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. The deferred tax provision represents the difference between the net deferred tax asset or liability at the beginning and end of the year. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The determination of the realization of the deferred tax assets is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence. The calculation of the Company's tax provision for federal income taxes is complex and requires the use of estimates and significant judgments in arriving at the amount of tax benefits to be recognized in the financial statements for a given tax position. It is possible that the tax benefits realized upon the ultimate resolution of a tax position may result in tax benefits that are significantly different from those estimated. The Company's policy is to classify interest and penalties associated with income taxes with other expenses.

Bank Owned Life Insurance (BOLI)

Bank owned life insurance policies are recorded at their cash surrender value or the amount that can be realized upon surrender of the policy. Income from BOLI is recognized when it is earned.

Goodwill

Goodwill represents costs in excess of net assets acquired and is evaluated at least annually for impairment, in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 350, "*Intangibles – Goodwill and Other*." The Company tested goodwill for impairment as of December 31, 2017 using the Step 0 method to evaluate impairment and concluded that the fair value of the goodwill is greater than the carrying value, noting no impairment of recorded goodwill. No events have occurred since December 31, 2017 that would require re-evaluation.

Intangible Assets

Intangible assets include non-competition and licensing agreements, and customer contracts and lists. The non-competition and licensing agreements are amortized by the straight-line method over four to five years. The customer contracts and lists are being amortized on either a straight-line method or performance basis over a period up to fifteen years. In 2017 and 2016, no circumstances existed that would indicate these assets were potentially impaired. If such circumstances had existed, the assets would have been tested for impairment in accordance with FASB ASC 350, "*Intangibles – Goodwill and Other*."

Insurance Revenue

Insurance revenue consists of commissions and fees from the sales of insurance policies and related insurance services. Insurance commission income is recognized as of the effective date of the insurance policy, net of adjustments, including policy cancellations. Such adjustments are recorded when the amount can be reasonably estimated, which is generally in the period in which they occur. For policies subject to cancellation or refund, income is recognized on a straight-line basis over the term of the policy. Contingent performance based commissions from insurance companies are recognized when received and no contingencies remain.

Advertising

Advertising costs are generally charged to expense during the year in which they are incurred. Advertising expense was $175,000 and $154,000 for the years ended December 31, 2017 and 2016, respectively.

Derivative Financial Instruments

The Company enters into interest rate swaps to convert fixed rate long-term loans to floating rate loans. Management individually evaluates and converts fixed rate loans to floating rate loans depending on the size, maturity, and planned amortization of each loan. The interest rate swap instruments are recognized as derivatives on the balance sheet at their fair value. On the date the derivative contract is entered into, the Company designates the derivative as a hedge of fair value of a recognized asset or liability. Changes in the fair value of a derivative that is highly effective, and that is designated and qualifies as a fair value hedge, along with the loss or gain on the hedged asset or liability that is attributable to the hedged risk, are recorded in current period earnings.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedged transactions. This process includes linking all derivatives that are designated as fair value hedges to specific assets and liabilities on the balance sheet and statement of cash flows. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values of hedged items. When it is determined that a derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively, as discussed below.

The Company discontinues hedge accounting prospectively when: (1) it is determined that the derivative is no longer effective in offsetting changes in the fair value of a hedged item; (2) the derivative expires or is sold, terminated, or exercised; or (3) management determines that designation of the derivative as a hedge instrument is no longer appropriate.

When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair value hedge, the derivative will continue to be carried on the balance sheet at its fair value with changes in its fair value recognized in current period earnings, and the hedged asset or liability will no longer be adjusted for changes in fair value.

Fair Value

The Company measures or monitors many of its assets and liabilities on a fair value basis. Fair value is used on a recurring basis for certain assets and liabilities in which fair value is the primary basis of accounting. Examples of these include derivative instruments and available for sale securities. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes. Examples of these non-recurring uses of fair value include certain loans held for sale accounted for on a lower of cost or market basis, impaired loans, foreclosed real estate, mortgage servicing rights, goodwill and long-lived assets.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. Fair value estimates are based on quoted market prices, if available. If quoted market prices are not available, fair value estimates are based on quoted market prices of similar assets or liabilities or the present value of expected future cash flows and other valuation techniques. These valuations are significantly affected by discount rates, cash flow assumptions, and risk and other assumptions used. Therefore, fair value estimates may not be substantiated by comparison to independent markets and are not intended to reflect the proceeds that may be realizable in an immediate settlement of the instruments.

Fair value is determined at one point in time and is not representative of future value. Fair value amounts also do not reflect the total value of a going concern organization. Management does not have the intention to dispose of a significant portion of its assets and liabilities and therefore, the unrealized gains or losses should not be interpreted as a forecast of future earnings and cash flows.

In support of these representations, FASB ASC 820, "*Fair Value Measurements and Disclosures*," establishes fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy is as follows:

> Level 1 inputs are observable inputs, based upon the quoted prices for identical instruments in active markets that are accessible as of the measurement date, and are to be used whenever available.
>
> Level 2 inputs are other types of observable inputs, such as quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are inactive; or other inputs that are observable or can be derived from or supported by observable market data. Level 2 inputs are to be used whenever Level 1 inputs are not available.
>
> Level 3 inputs are significantly unobservable and are supported by little or no market activity. These Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation. Level 3 inputs are to only be used when Level 1 and Level 2 inputs are unavailable.

When determining the fair value measurements for assets and liabilities, the Company considers the principal or most advantageous market in which it would transact, and considers assumptions that market participants would use when pricing the asset or liability. When possible, the Company looks to active and observable markets to price identical assets or liabilities. When identical assets or liabilities are not traded in active markets, the Company looks to market observable data for similar assets and liabilities.

Recent Accounting Pronouncements

In February 2018, the FASB issued *ASU 2018-02, "Income Statement-Reporting Comprehensive Income (Topic 220)"* which is effective for all entities for fiscal years beginning after December 15, 2018; however, the Company elected to early adopt ASU 2018-02 as of December 31, 2017. ASU 2018-02 allows an entity an election to reclassify the income tax effects of items within accumulated other comprehensive to retained earnings. The amount of the reclassification includes the effect of the change in U.S. federal corporate income tax rate on the gross deferred tax amounts and related valuation allowances, if any. If an entity does not make this election, the amendment requires the entity to disclose that an election was not made to make the reclassification. The impact of adopting ASU 2018-02 is reflected in the Statement of Shareholders' Equity.

In January 2017, FASB issued Accounting Standards Update (ASU) No. 2017-04, "*Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,"* or ASU 2017-04, which eliminates Step 2 from the goodwill impairment test. ASU 2017-04 also eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Adoption of ASU 2017-04 is required for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019 with early adoption being permitted for annual or interim goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, "*Business Combinations Clarifying the Definition of a Business (Topic 805),"* for determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The new standard is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017 with early adoption permitted for transactions that occurred before the issuance date or effective date of the standard if the transactions were not reported in financial statements that have been issued or made available for issuance. The standard must be applied prospectively. Upon adoption, the standard will impact how we assess acquisitions (or disposals) of assets or businesses. The Company does not expect the adoption of ASU 2017-01 to have a material impact on its consolidated financial statements.

On November 17, 2016, the FASB issued ASU No. 2016-18, *"Statement of Cash Flows: Restricted Cash: a Consensus of the FASB Emerging Issues Task Force (Topic 230)."* This ASU requires a company's cash flow statement to explain the changes during a reporting period of the totals for cash, cash equivalents, restricted cash, and restricted cash equivalents. Additionally, amounts for restricted cash and restricted cash equivalents are to be included with cash and cash equivalents if the cash flow statement includes a reconciliation of the total cash balances for a reporting period. This ASU is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017, with early application permitted. The Company does not anticipate that this guidance will have a material impact on its consolidated financial statements.

On August 26, 2016, the FASB issued ASU No. 2016-15, "*Statement of Cash Flows, Classification of Certain Cash Receipts and Cash Payments (Topic 230)."* The amendments in this ASU were issued to reduce diversity in how certain cash receipts and payments are presented and classified in the statement of cash flows in eight specific areas. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years and should be applied using a retrospective transition method to each period presented. Early application was permitted upon issuance of the ASU. The Company is currently evaluating the impact of this ASU and the Company does not expect this ASU to have a material impact on the Company's consolidated financial statements.

On June 16, 2016, the FASB issued ASU No. 2016-13, "*Financial Instruments-Credit Losses (Topic 326)."* The amendments in this ASU were issued to provide financial statement users with more decision-useful information about the current expected credit losses (CECL) on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other commitments to extend credit held by a reporting entity at each reporting date. The amendments to this ASU require that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The amendments in this ASU eliminate the requirement that losses be recognized only when incurred, and instead require that an entity recognize its current estimate of all expected credit losses. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets.

For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination (PCD assets) that are measured at amortized cost, the initial allowance for credit losses is added to the purchase price rather than being reported as a credit loss expense. Subsequent changes in the allowance for credit losses on PCD assets are recognized through the statement of income as a credit loss expense.

Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security.

The amendments to this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The amendments in this ASU should be applied on a modified-retrospective transition approach that would require a cumulative-effect adjustment to the opening retained earnings in the statement of financial condition as of the date of adoption. A prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. The Company is currently evaluating the impact of this ASU and the Company expects this ASU to have a material impact on the Company's consolidated financial statements.

On February 25, 2016, the FASB issued ASU No. 2016-02, *"Leases (Topic 842)."* The amendments in this ASU require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. This ASU simplifies the accounting for sale and leaseback transactions. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application was permitted upon issuance of the ASU. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently evaluating the provisions of this guidance to determine the potential impact the new standard will have on the Company's consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, "*Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*." The new guidance is intended to improve the recognition and measurement of financial instruments. This ASU requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. In addition, the amendment requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. This ASU also eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. The amendment also requires a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument specific credit risk (also referred to as "own credit") when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU No. 2016-01 is effective for financial statements issued for fiscal years beginning after December 15, 2017. The Company is currently evaluating the provisions of this guidance to determine the potential impact the new standard will have on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, "*Revenue from Contracts with Customers (Topic 606)."* This ASU clarifies the principles for recognizing revenue from contracts with customers. On August 12, 2015, the FASB issued ASU 2015-14 to defer the effective date of ASU 2014-09. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. On March 17, 2016, the FASB issued Accounting Standards Update 2016-08 to clarify the implementation guidance on principal versus agent considerations. We will adopt this ASU on January 1, 2018 utilizing the modified retrospective approach with a cumulative effect adjustment to opening retained earnings. Management is in process of completing an analysis to determine which revenue streams are within the scope of ASU 2014-09 and the related clarifying ASU's and has determined that interest income and revenue generated from transfers and servicing of financial instruments, specifically, gain on sale of loans and mortgage servicing fees are out of scope. Management is continuing to evaluate the most appropriate transition method of application and the impact that ASU 2014-09 and the related clarifying ASU's will have on in scope revenue streams, specifically, service charges and fees, mortgage referral fees, gains or losses on other real estate owned, commissions on mutual funds and annuities and commissions on insurance policies. Expanded disclosure requirements will be included in the 2018 consolidated financial statements.

Note 2 – Business Combinations

Gellatly Agency, Inc.

On April 1, 2017, the Bank acquired Gellatly Agency, Inc., an insurance agency and brokerage business in Wenatchee, Washington.

The purchase price for the assets included cash at the time of the merger plus a percentage of the total commissions of the seller earned and collected from April 1, 2017 to March 31, 2022.

The Gellatly merger was accounted for using the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date. Preliminary goodwill of $277,000 was calculated as the purchase premium after adjusting for the fair value of net assets acquired and represents the value expected from the synergies created and the economies of scale expected from combining the two organizations.

In most instances, determining the fair value of the acquired assets and assumed liabilities required us to estimate cash flows expected to result from those assets and liabilities and to discount those cash flows at appropriate rates of interest.

The following table provides a summary of the purchase price calculation as of the acquisition date and the identifiable assets purchased and the liabilities assumed at their estimated fair values. These fair value measurements are provisional based on third-party valuations that are currently under review and are subject to refinement for up to one year after the acquisition date based on additional information that may be obtained by us that existed as of the acquisition date.

Assets:	
Premises and equipment	8,000
Non-compete agreement	20,000
Intangible asset – Gellatly portfolio	709,000
Goodwill	277,000
Purchase Price:	
Total purchase price	$1,014,000

Elliott Insurance Service, Inc.

On July 1, 2017, the Bank acquired Elliott Insurance Service, Inc., an insurance agency and brokerage business in Yakima, Washington.

The purchase price for the assets included cash at the time of the merger plus a percentage of the total commissions of the seller earned and collected from July 1, 2017 to June 30, 2022.

The Elliott merger was accounted for using the acquisition method of accounting and accordingly, assets acquired, liabilities assumed and consideration exchanged were recorded at estimated fair value on the acquisition date. Preliminary goodwill of $207,000 was calculated as the purchase premium after adjusting for the fair value of net assets acquired and represents the value expected from the synergies created and the economies of scale expected from combining the two organizations.

In most instances, determining the fair value of the acquired assets and assumed liabilities required us to estimate cash flows expected to result from those assets and liabilities and to discount those cash flows at appropriate rates of interest.

The following table provides a summary of the purchase price calculation as of the acquisition date and the identifiable assets purchased and the liabilities assumed at their estimated fair values. These fair value measurements are provisional based on third-party valuations that are currently under review and are subject to refinement for up to one year after the acquisition date based on additional information that may be obtained by us that existed as of the acquisition date.

Assets:	
Premises and equipment	10,000
Supplies	1,000
Non-compete agreement	5,000
Intangible asset – Elliott portfolio	2,090,000
Goodwill	206,000
Purchase Price:	
Total purchase price	$2,312,000

All merger-related charges were recorded in the consolidated statement of income and comprehensive income for the year ended December 31, 2017. Such expenses were for human resources and professional services, among other categories, and including legal and accounting support.

Pro forma income statements are not being presented as the information is not practicable to produce.

Note 3 – Restricted Assets

Federal Reserve Board regulations require that the Company maintain certain minimum reserve balances on hand or on deposit with the Federal Reserve Bank, based on a percentage of deposits. The required minimum reserve balances at December 31, 2017 and 2016 were $2,229,000 and $1,590,000, respectively. Due to sufficient balances maintained on premises, no balances were required to be on deposit with the Federal Reserve Bank for the years ended December 31, 2017 and 2016.

Note 4 – Securities

Securities have been classified according to management's intent. The amortized cost of securities and their approximate fair value are as follows (dollars in thousands):

Securities Available for Sale	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
December 31, 2017				
Money market funds	$21	$--	$--	$21
State and municipal securities	258,976	5,533	(704)	263,805
Collateralized mortgage obligations	177,591	631	(2,377)	175,845
Mortgage-backed securities	75,124	280	(227)	75,177
Total	$511,712	$6,444	$(3,308)	$514,848
December 31, 2016				
Money market funds	$21	$--	$--	$21
State and municipal securities	153,723	4,229	(407)	157,545
Collateralized mortgage obligations	208,044	1,500	(2,057)	207,487
Mortgage-backed securities	49,299	277	(498)	49,078
Total	$411,087	$6,006	$(2,962)	$414,131

Securities Held to Maturity	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
State and municipal securities	$40	$--	$--	$40
Tax-exempt municipals	513	--	(15)	498
Mortgage-backed securities	986	--	(1)	985
Total	$1,539	$--	$(16)	$1,523
December 31, 2016				
State and municipal securities	$43	$--	$--	$43
Tax-exempt municipals	503	--	(15)	488
Mortgage-backed securities	1,005	--	(3)	1,002
Total	$1,551	$--	$(18)	$1,533

In determining that no securities were other-than-temporarily impaired, each security was individually evaluated for impairment by management. On a quarterly basis, the Company evaluates these securities for other-than-temporarily impairment (OTTI). During 2017 and 2016 there was no OTTI recorded in earnings. The unrealized losses on securities are primarily due to elevated yield spreads at December 31, 2017 and 2016 as compared to yield relationships prevailing at the time specific securities were purchased.

At December 31, 2017, there were thirty-six securities in a continuous unrealized loss position more than twelve months. The following shows the unrealized gross losses and fair value of securities in the available for sale portfolio at December 31, 2017 and 2016, by length of time that individual securities in each category have been in a continuous loss position (dollars in thousands):

	Less Than 12 Months		More Than 12 Months		Total	
	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value
December 31, 2017						
U.S. Government agency securities, including mortgage-backed securities	$(115)	$34,973	$(112)	$8,765	$(227)	$43,738
State and municipal securities	(603)	45,269	(101)	5,587	(704)	50,856
Collateralized mortgage obligations	(698)	93,027	(1,679)	47,199	(2,377)	140,226
Total	**$(1,416)**	**$173,269**	**$(1,892)**	**$61,551**	**$(3,308)**	**$234,820**

	Less Than 12 Months		More Than 12 Months		Total	
	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value	Unrealized Gross Loss	Fair Value
December 31, 2016						
U.S. Government agency securities, including mortgage-backed securities	$(394)	$29,811	$(104)	$6,077	$(498)	$35,888
State and municipal securities	(407)	25,901	--	--	(407)	25,901
Collateralized mortgage obligations	(1,885)	108,836	(172)	11,821	(2,057)	120,657
Total	**$(2,686)**	**$164,548**	**$(276)**	**$17,898**	**$(2,962)**	**$182,446**

The contractual maturities of securities held to maturity and available for sale at December 31, 2017, are shown below (dollars in thousands):

	Held to Maturity		Available for Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$--	$--	$7,727	$7,796
Due from one year to five years	--	--	92,034	93,213
Due from five years to ten years	1,499	1,483	107,784	108,152
Due after ten years	40	40	304,167	305,687
Total	**$1,539**	**$1,523**	**$511,712**	**$514,848**

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations, with or without call or prepayment penalties.

Securities carried at approximately $100.6 million and $173.8 million at December 31, 2017 and 2016, respectively, were pledged to secure public deposits, repurchase agreements, and other purposes required or permitted by law.

Sales of securities available for sale were as follows (dollars in thousands):

	2017	2016
Proceeds from sales	$46,257	$69,444
Gross realized gains included in earnings	622	581
Gross realized losses included in earnings	(183)	(2,506)

No held to maturity securities were sold in 2017 or 2016.

Note 5 – Loans and Leases

Loans and leases at December 31 consist of the following (dollars in thousands):

	2017	2016
Commercial and agricultural	$61,093	$59,528
Real estate:		
Residential 1-4 family	143,913	138,993
Commercial	329,329	315,515
Construction	46,794	47,597
Farmland	9,773	10,362
Municipal	113,622	111,880
Consumer	17,845	19,121
Dealer contracts	162,795	160,960
Leases	2,155	1,153
Credit card	5,533	5,684
Plus deferred loan costs, less deferred loan fees	1,398	1,261
Total loans and leases	**$894,250**	**$872,054**

In the ordinary course of business, the Company has transactions with directors, principal officers, their immediate families, and affiliated companies in which they are principal shareholders (commonly referred to as related parties), all of which have been, in the opinion of management, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with outside parties. Total loans outstanding at December 31, 2017 and 2016 to key officers and directors were $21,490,000 and $23,468,000, respectively. During 2017 and 2016 loan advances totaled $3,043,000 and $1,679,000, respectively and principal payments totaled $5,015,000 and $2,078,000, respectively.

The following tables detail activity in the allowance for loan and lease losses (ALLL) by portfolio segment for the years ended December 31, 2017 and 2016 (dollars in thousands). Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

		Real Estate					
2017	**Commercial and Agricultural**	**Residential 1-4 Family**	**Commercial, Construction, and Farmland**	**Municipal**	**Consumer and Other**	**Unallocated**	**Total ALLL**
Beginning Balance	$895	$1,110	$6,316	$111	$2,576	$29	$11,037
Provision for loan and lease losses	(155)	(15)	(919)	9	482	598	--
Charge-offs	(179)	--	--	--	(705)	--	(884)
Recoveries	231	--	24	--	231	--	486
Net Charge-offs	52	--	24	--	(474)	--	(398)
Ending balance	$792	$1,095	$5,421	$120	$2,584	$627	$10,639
Period end amount allocated to:							
Loans and leases individually evaluated for impairment	$2	$177	$74	$--	$1	$--	$254
Loans and leases collectively evaluated for impairment	790	918	5,347	120	2,583	627	10,385
Ending balance	$792	$1,095	$5,421	$120	$2,584	$627	$10,639

		Real Estate					
2016	**Commercial and Agricultural**	**Residential 1-4 Family**	**Commercial, Construction, and Farmland**	**Municipal**	**Consumer and Other**	**Unallocated**	**Total ALLL**
Beginning Balance	$1,027	$1,194	$7,285	$101	$2,417	$565	$12,589
Provision for loan and lease losses	284	72	(1,009)	10	445	(536)	(734)
Charge-offs	(864)	(200)	(135)	--	(546)	--	(1,745)
Recoveries	448	44	175	--	260	--	927
Net Charge-offs	(416)	(156)	40	--	(286)	--	(818)
Ending balance	$895	$1,110	$6,316	$111	$2,576	$29	$11,037
Period end amount allocated to:							
Loans and leases individually evaluated for impairment	$4	$155	$64	$--	$4	$--	$227
Loans and leases collectively evaluated for impairment	891	955	6,252	111	2,572	29	10,810
Ending balance	$895	$1,110	$6,316	$111	$2,576	$29	$11,037

The Company had a previously recorded $235,000 reserve for possible losses on unfunded commitments as of December 31, 2016. No adjustment to the reserve was required in 2017. The total reserve for possible losses on unfunded commitments was $235,000 as of December 31, 2017.

The Company's recorded investment in loans and leases as of December 31, 2017 and 2016 related to each balance in the allowance for loan and lease losses by portfolio segment and disaggregated on the basis of the Company's impairment methodology was as follows (dollars in thousands):

	Commercial and Agricultural	Real Estate		Municipal	Consumer and Other	Total Loans and Leases
		Residential 1-4 Family	Commercial, Construction, and Farmland			
2017						
Loans and leases individually evaluated for impairment	$1,337	$5,905	$2,977	$--	$169	$10,388
Loans and leases collectively evaluated for impairment	59,756	138,008	382,919	113,622	189,557	883,862
Ending balance	$61,093	$143,913	$385,896	$113,622	$189,726	$894,250
2016						
Loans and leases individually evaluated for impairment	$1,353	$4,683	$4,451	$--	$--	$10,487
Loans and leases collectively evaluated for impairment	58,175	134,310	369,023	111,880	188,179	861,567
Ending balance	$59,528	$138,993	$373,474	$111,880	$188,179	$872,054

A summary of loans and leases by age, segregated by class of loans and leases, as of December 31, 2017 and 2016 was as follows (dollars in thousands):

2017	Loans and Leases 30-89 Days Past Due	Loans and Leases 90 or More Days Past Due	Total Past Due Loans and Leases	Current Loans and Leases	Total Loans and Leases	Accruing Loans 90 or more Days Past Due
Commercial and agricultural	$68	$--	$68	$61,025	$61,093	$--
Residential 1-4 family real estate	28	--	28	143,885	143,913	--
Commercial, construction, and farmland real estate	136	51	187	385,709	385,896	--
Municipal	--	--	--	113,622	113,622	--
Consumer and other	737	119	856	188,870	189,726	24
Total	$969	$170	$1,139	$893,111	$894,250	$24
2016						
Commercial and agricultural	$470	$--	$470	$59,058	$59,528	--
Residential 1-4 family real estate	918	--	918	138,075	138,993	--
Commercial, construction, and farmland real estate	360	--	360	373,114	373,474	--
Municipal	--	--	--	111,880	111,880	--
Consumer and other	739	--	739	187,440	188,179	--
Total	$2,487	$--	$2,487	$869,567	$872,054	$--

Nonaccrual Loans:

	2017	**2016**
Commercial and agricultural	$--	$--
Residential 1-4 family real estate	--	--
Commercial, construction, and farmland real estate	51	117
Municipal	--	--
Consumer and other	95	49
Total	$146	$166

The following table provides information with respect to impaired loans as of the years ended December 31, 2017 and 2016 (dollars in thousands):

2017	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment
Commercial and agricultural	$1,337	$1,290	$47	$1,337	$2	$1,318
Residential 1-4 family real estate	5,905	3,261	2,644	5,905	177	5,425
Commercial, construction, and farmland real estate	2,977	1,724	1,253	2,977	74	3,092
Municipal	--	--	--	--	--	--
Consumer and other	169	--	169	169	1	240
Total	$10,388	$6,275	$4,113	$10,388	$254	$10,075
2016						
Commercial and agricultural	$1,353	$1,301	$52	$1,353	$3	$1,449
Residential 1-4 family real estate	5,080	2,451	2,629	5,080	155	3,628
Commercial, construction, and farmland real estate	4,350	2,045	2,248	4,293	64	4,368
Municipal	--	--	--	--	--	--
Consumer and other	188	--	188	188	4	200
Total	$10,971	$5,797	$5,117	$10,914	$226	$9,645

At December 31, 2017, there were no commitments to lend additional funds to borrowers whose loans have been impaired. Loans over 90 days past due still accruing interest totaled $24,000 at December 31, 2017 and none at December 31, 2016.

No interest income in 2017 was recognized on a cash basis for impaired loans, whereas $451,000 was recognized in 2016. All impaired loans were paying according to terms and were accruing interest income in 2017.

The Company assigns risk rating classifications to its loans. These risk ratings are divided into the following groups:

Pass – asset is considered of sufficient quality to preclude a Special Mention or an adverse rating. Pass assets generally are well protected by the current net worth and paying capacity of the obligor, by the value of the asset, or the underlying collateral.

Special Mention – asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Company's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Substandard – asset is inadequately protected by the current net worth and paying capacity of the obligor or by the collateral pledged, if any. Assets so classified have well-defined weaknesses. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – asset has the weaknesses of those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Credit quality indicators for the Company's loan portfolio as of December 31, 2017 and 2016 grouped according to internally assigned risk ratings and payment activity (dollars in thousands):

		Real Estate				
	Commercial and Agricultural	Residential 1-4 Family	Commercial, Construction, and Farmland	Municipal	Consumer and Other	Total Loans and Leases
2017						
Pass	$59,205	$134,120	$364,959	$113,622	$186,960	$858,866
Special Mention	420	3,586	2,216	--	2,297	8,519
Substandard	1,468	6,207	18,721	--	464	26,860
Doubtful	--	--	--	--	5	5
Total Loans and Leases	$61,093	$143,913	$385,896	$113,622	$189,726	$894,250
Restructured	$--	$--	$118	$--	$24	$142
Nonaccrual	--	--	51	--	95	146
Nonperforming	--	--	169	--	119	288
Performing	61,093	143,913	385,727	113,622	189,607	893,962
Total Loans and Leases	$61,093	$143,913	$385,896	$113,622	$189,726	$894,250

		Real Estate				
	Commercial and Agricultural	Residential 1-4 Family	Commercial, Construction, and Farmland	Municipal	Consumer and Other	Total Loans and Leases
2016						
Pass	$55,787	$128,983	$351,655	$111,880	$184,777	$833,082
Special Mention	475	2,297	1,455	--	1,931	6,158
Substandard	3,266	7,713	20,364	--	1,465	32,808
Doubtful	--	--	--	--	6	6
Total Loans and Leases	$59,528	$138,993	$373,474	$111,880	$188,179	$872,054
Restructured	$--	$2,208	$2,891	$--	$--	$5,099
Nonaccrual	--	--	117	--	49	166
Nonperforming	--	2,208	3,008	--	49	5,265
Performing	59,528	136,785	370,466	111,880	188,130	866,789
Total Loans and Leases	$59,528	$138,993	$373,474	$111,880	$188,179	$872,054

Restructured loans are defined as the period end outstanding balance of loans that previously under went a troubled debt restructuring.

The following table presents by class troubled debt restructurings (TDRs) recorded during the years ended December 31, 2017 and 2016 (dollars in thousands, except number of contracts):

2017	Number of Contracts	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial and agricultural	2	$80	$80
Residential 1-4 family real estate	15	3,442	3,442
Commercial, construction, and farmland real estate	12	1,282	1,282
Municipal	--	--	--
Consumer and other	--	--	--
Total*	29	$4,804	$4,804

*Amounts exclude specific loan loss reserves

2016	Number of Contracts	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Commercial and agricultural	1	$11	$11
Residential 1-4 family real estate	8	2,531	2,572
Commercial, construction, and farmland real estate	13	1,924	1,867
Municipal	--	--	--
Consumer and other	--	--	--
Total*	22	$4,466	$4,450

*Amounts exclude specific loan loss reserves

The majority of TDRs are determined to be impaired prior to being restructured. As such, they are individually evaluated for impairment, unless they are considered homogeneous loans in which case they are collectively evaluated for impairment. As of December 31, 2017 the Company had $254,000 in specific reserves on TDRs which were restructured during the year ended December 31, 2017. The primary type of concession granted in all TDRs during the year ended December 31, 2017 was maturity extensions. There were no TDRs that were restructured and subsequently defaulted during the year ended December 31, 2017.

Note 6 - Premises and Equipment

Components of premises and equipment at December 31 are as follows (dollars in thousands):

	2017	2016
Land	$3,725	$3,725
Buildings and improvements	15,668	15,073
Furniture	5,140	5,044
Equipment	3,435	2,529
Assets in process	2,655	815
Total cost	30,623	27,186
Less accumulated depreciation	(13,789)	(12,936)
Total premises and equipment	$16,834	$14,250

As of December 31, 2017 there was a $1 million commitment for capital expenditures. There were no material commitments as of December 31, 2016.

Depreciation expense was $1,411,000 and $1,245,000 in 2017 and 2016, respectively.

Note 7 – Goodwill and Other Intangible Assets

The Bank recorded approximately $300,000 of goodwill and $729,000 of amortizable intangible assets in connection with the Gellatly Agency, Inc. merger that occurred on April 1, 2017.

The Bank recorded approximately $100,000 of goodwill and $2,095,000 of amortizable intangible assets in connection with the Elliott Insurance Service, Inc. merger that occurred on July 1, 2017.

Note 8– Mortgage Servicing Rights

Mortgage servicing rights (MSRs) are evaluated periodically for possible impairment based on the difference between the carrying amount and current fair value of the MSRs by risk stratification. If a temporary impairment exists, a valuation allowance is established for any excess of amortized cost over the current fair value through a charge to income. A direct write-down is performed when the recoverability of a recorded valuation allowance is determined to be remote. Unlike a valuation allowance, a direct write-down permanently reduces the carrying value of the MSR and the valuation allowance, precluding subsequent reversals.

Mortgage loans serviced for others are not included on the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were $393,051,000 and $392,195,000 at December 31, 2017 and 2016, respectively. Custodial escrow balances maintained in connection with the foregoing loan servicing were approximately $2,181,000 and $2,070,000 at December 31, 2017 and 2016, respectively. The weighted average amortization period of the Company's servicing rights was 6.6 years and 6.8 years in 2017 and 2016.

The following summarizes the activity in mortgage servicing rights for the years ended December 31 (dollars in thousands):

	2017	**2016**
Balance as of beginning of year	$1,723	$1,768
Originations	265	282
Amortization	(292)	(327)
Adjustment valuation	--	--
Balance as of end of year	$1,696	$1,723

The estimated fair value of the Company's MSRs portfolio was $3,952,000 and $3,892,000 at December 31, 2017 and 2016, respectively. Fair value of mortgage servicing rights is based on market prices for comparable mortgage servicing contracts when available. In periods of market inactivity, fair value is determined using a discounted cash flow analysis, utilizing observable market data with unobservable adjustments. The analysis takes into consideration existing conditions in the secondary servicing markets, such as prices from recently executed servicing transactions and market discount rates. The adjustments made to observable data include adjustments for delinquency, and loss rates.

Note 9 - Deposits

The composition of deposits is as follows (dollars in thousands):

	Deposits at December 31		**Interest Expense for the Years Ended December 31**	
	2017	**2016**	**2017**	**2016**
Noninterest bearing demand deposits	$218,418	$199,633	$--	$--
NOW accounts	245,170	230,352	365	245
Money market and savings accounts	617,314	599,958	1,207	1,270
Time deposits greater than $250,000	35,736	37,109	452	465
Time deposits $250,000 or less	197,664	201,974	2,414	2,316
Total	$1,314,302	$1,269,026	$4,438	$4,296

Time deposits at December 31, 2017, are scheduled to mature as follows (dollars in thousands):

	$250,000 or Less	**Greater than $250,000**
0 to 90 days	$20,407	$4,771
91 to 365 days	59,076	7,613
1 year to 3 years	93,502	16,011
Over 3 years	24,679	7,341
Total	$197,664	$35,736

Total deposits at December 31, 2017 and 2016 by key officers and directors were $6,290,000 and $6,790,000, respectively.

Cashier's check deposits of $3.3 million and $3.1 million are included in total demand deposits for 2017 and 2016, respectively.

Total demand deposit overdrafts that have been reclassified to loans were $224,000 and $57,000 at December 31, 2017 and 2016, respectively.

The Company is a State of Washington Public Depository. All such public depositaries are required to be members of Washington State's Public Deposit Protection Commission (PDPC). As such, when there is a loss of public funds at a member institution, those funds are in most instances insured to some extent by the federal government. To the degree a public deposit is not insured by the federal government, the PDPC will assess a claim first against the institution responsible for the loss and then against the pool of collateral held by other PDPC member institutions. Each institution is then responsible to pay its portion of the cost in proportion to the share of public funds held by that institution. The Company held $35,068,000 and $28,490,000 of public deposits as of December 31, 2017 and 2016, respectively.

Note 10 - Short-Term Borrowings

Securities sold under agreements to repurchase and line of credit advances from the Federal Home Loan Bank Des Moines (FHLB) represent short-term borrowings. The outstanding balances for line of credit advances were $304,000 and $285,000 at December 31, 2017 and 2016, respectively. The weighted average interest rates for line of credit advances were 5.92% and 5.96% at December 31, 2017 and 2016, respectively. Securities sold under agreements to repurchase are secured by specific securities which, in all cases, the Company maintains control. The securities underlying agreements to repurchase entered into by the Company are for the same securities originally sold, with a one-day maturity.

The following is a summary of such short-term borrowings for the years ended December 31 (dollars in thousands):

	2017	2016
Average balance during the year	$8,601	$11,501
Average interest rate during the year	1.27%	1.17%
Maximum month end balance during the year	$10,710	$14,312
Balance at December 31:		
Securities under agreements to repurchase	$7,030	$11,467
Weighted average interest rate at year end	0.18%	0.20%
Carrying value of underlying securities	$19,682	$30,727
Market value of underlying securities	$19,718	$30,720

Note 11 - Long-Term Borrowings

Long-term borrowings at December 31, 2017 and 2016 represent amounts due to the FHLB totaling $1,815,000 and $2,119,000, respectively, and bear fixed interest rates ranging from 5.42% to 6.23%. All funds borrowed from the FHLB are secured by a blanket pledge of 15% of the Company's assets. The schedule of maturities for the long-term FHLB borrowings for future years ending December 31 is as follows (dollars in thousands):

2019	$324
2020	346
2021	295
2022	850
	$1,815

Note 12 - Income Taxes

On December 22, 2017, the United States enacted the Tax Cuts and Jobs Act (the "Act") resulting in significant modifications to existing law. We have completed the accounting for the effects of the Act during the quarter ended December 31, 2017. Our financial statements for the year ended December 31, 2017, reflect certain effects of the Act which includes a reduction in the corporate tax rate from 35.0% to 21.0% as well as other changes. As a result of the changes to tax laws and tax rates under the Act, we incurred incremental income tax expense of $312 during the year ended December 31, 2017, which consisted primarily of the remeasurement of deferred tax assets and liabilities from 35.0% to 21.0%.

Income taxes are comprised of the following for the years ended December 31 (dollars in thousands):

	2017	2016
Current	$4,538	$3,886
Deferred	(50)	643
State income taxes	35	24
Total income taxes	$4,523	$4,553

The following is a reconciliation of the statutory income tax rate to the effective income tax rate for the years ended December 31 (dollars in thousands):

	2017		2016	
	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income
Income tax at statutory rates	$8,026	35.0%	$7,722	35.0%
Increase resulting from:				
State income tax	35	0.2%	24	0.1%
Tax Cuts and Jobs Act	312	1.4%	--	0.0%
Decrease resulting from:				
Tax-exempt income	(3,182)	(13.9%)	(2,602)	(11.8%)
Tax Credits	(520)	(2.3%)	(582)	(2.6%)
Other	(148)	(0.6%)	(9)	(0.04%)
Total income tax expense	$4,523	19.8%	$4,553	20.7%

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities at December 31 are as follows (dollars in thousands):

	2017	2016
Deferred Tax Assets:		
Allowance for credit losses	$2,234	$3,863
Deferred compensation	504	784
Other	606	675
Total deferred tax assets	3,344	5,322
Deferred Tax Liabilities:		
Accumulated depreciation and amortization	$1,286	$2,243
Deferred income	438	733
Unrealized gain on securities available for sale	659	1,065
Mortgage servicing rights	355	600
FHLB dividends	138	230
Total deferred tax liabilities	2,876	4,871
Net deferred tax assets	$468	$451

Note 13 - Commitments and Contingencies

Credit

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized on the consolidated balance sheets.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for balance sheet instruments.

A summary of the Company's commitments at December 31 is as follows (dollars in thousands):

	2017	2016
Commitments to extend credit:		
Credit card lines	$33,029	$36,475
Commercial real estate, construction and development	45,660	18,483
Other	100,619	89,374
Total commitments to extend credit	$179,308	$144,332
Standby letters of credit	$164	$193

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company's experience has been that between approximately 10% and 25% of loan commitments are drawn upon by customers. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Associated with the unfunded commitment, the Company has established a loss reserve in the amount of $235,000 as of December 31, 2017 and 2016.

Standby Letters of Credit

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third-party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. In certain circumstances collateral is deemed necessary to secure the commitment.

Legal

Because of the nature of its activities, the Company is subject to various pending and threatened legal actions which arise in the ordinary course of business. In the opinion of management, liabilities arising from these claims, if any, will not have a material effect on the financial position of the Company.

Borrowing Facilities

The Company has agreements with commercial banks for lines of credit totaling $44,000,000, none of which was used at December 31, 2017. A credit line with the Federal Home Loan Bank of Des Moines totaling 35% of assets which approximates $530,605,000 of which $2,119,000 was outstanding at December 31, 2017. The Company entered into a Blanket Pledge Agreement with the Federal Home Loan Bank to secure this credit line (Note 10).

Investments

The Company entered into a subscription agreement to purchase four units at $500,000 per unit for an interest in Homestead Equity Fund A Washington Limited Partnership (HEFA-WA) for which funding has been completed. HEFA-WA has been formed to invest in partnerships or limited liability companies, which will acquire, construct, rehabilitate, operate, and dispose of low income housing developments which are located in Washington State. The housing developments will be eligible for the federal low income housing tax credit and, in some cases, the historic rehabilitation tax credit available under the Internal Revenue Code of 1986, as amended. The Company accounts for the investment under the equity method in accordance with ASC 323, "*Investments – Equity Method and Joint Ventures,*" and a pass-through loss of $32,000 and $46,000 was recorded during 2017 and 2016, respectively. At December 31, 2017 and 2016, the Company's partnership equity was $98,000 and $134,000, respectively, and is included in other assets.

The Company entered into a subscription agreement to purchase one unit at $1,000,000 for an interest in Homestead Western Communities Fund Limited Partnership (HWCF) for which funding has been completed. HWCF has been formed to invest in partnerships or limited liability companies, which will acquire, construct, rehabilitate, operate, and dispose of low income housing developments which are located in the states of Oregon, Washington, Idaho, and California. The housing developments will be eligible for the federal low income housing tax credit and, in some cases, the historic rehabilitation tax credit available under the Internal Revenue Code of 1986, as amended. The Company accounts for the investment under the equity method in accordance with ASC 323, "*Investments – Equity Method and Joint Ventures,*" and a pass-through loss of $22,000 and $64,000 was recorded during 2017 and 2016, respectively. At December 31, 2017 and 2016, the Company's partnership equity was $75,000 and $120,000 respectively.

The Company entered into a subscription agreement to purchase five units at $1,000,000 per unit for an interest in Homestead Equity Fund X Limited Partnership (HEF-X). HEF-X has been formed to invest in partnerships or limited liability companies, which will acquire, construct, rehabilitate, operate, and dispose of low income housing developments primarily located in the states of Oregon, Washington, Idaho, and California. The housing developments will be eligible for the federal low income housing tax credit and, in some cases, the historic rehabilitation tax credit available under the Internal Revenue Code of 1986, as amended. The Company accounts for the investment under the equity method in accordance with ASC 323, "*Investments – Equity Method and Joint Ventures*" and a pass-through loss of $309,000 and $225,000 was recorded during 2017 and 2016, respectively. At December 31, 2017 and 2016, the Company's partnership equity was $3,862,000 and $4,053,000 respectively.

The Company's remaining contractual contribution for Homestead Equity Fund X (HEF-X) of $147,000 is expected to be paid as follows (dollars in thousands):

2018	$21
2019	21
2020	21
2021	84
	$147

Employment Agreements

The Company has entered into employment contracts with certain key employees, which provide for contingent payments subject to future events. These agreements are discussed in Note 13.

Derivatives

For the years ended December 31, 2017 and 2016, the fair value of the hedged loans of $278,000 and $371,000 respectively, are recorded in loans held for investment and the related swap liability is recorded in other liabilities at $278,000 and $371,000, respectively. The Company pledged a certificate of deposit due from the counterparty of the hedging instruments as collateral for the swap liability. This certificate of deposit had a balance of $550,000 at December 31, 2017 and 2016. The notional amounts of the interest rate swaps were $6,466,000 and $6,831,000 at December 31, 2017 and 2016, respectively. The Company recognized no loss in 2017 and 2016 which represents the ineffective portion of all fair value hedges. All components of each derivative's gain or loss are included in the assessment of hedge effectiveness, unless otherwise noted.

Note 14 – Significant Concentration of Credit Risk

Most of the Company's business activity is with customers located in the state of Washington. Investments in state and municipal securities involve government entities primarily within the state. At December 31, 2017, 5.23% of total loans outstanding were for construction related projects. Of those, 2.18% of total loans outstanding were residential developed lot loans to consumers.

Loans are generally limited, by state banking regulations, to 20% of the Company's capital to any one borrower, excluding accumulated other comprehensive income. At December 31, 2017 the Bank's legal lending limit was $35,792,000. Standby letters of credit were granted primarily to commercial borrowers. The Company, as a matter of practice, generally does not extend credit to any single borrower or group of related borrowers in excess of $20,200,000. At December 31, 2017, one borrowing relationship was in excess of this limit at $22,550,000.

Note 15 - Employee Compensation Plans

Stock Option Plan

The Company has a stock option plan under which certain key employees have been granted options to purchase shares of common stock. Under the plan, the Company may grant options of its common stock to certain key employees, of which 300,344 were available for grant at December 31, 2017. Options have an exercise price equal to the fair market value of the stock as of the date of grant. Generally, options granted are 40% vested on the date of grant, with 20% vesting on each of the three subsequent anniversaries of the grant date and have a maximum contractual term of ten years. The Black-Scholes model requires the use of assumptions noted in the following table. The dividend yield is based on the Company's actual and expected dividends paid to shareholders. The Company uses historical data to estimate the option exercise and forfeitures to estimate the expected life, which represents the period of time the options are expected to be outstanding. Expected stock price volatility is based on the Company's historical stock price, adjusted for dividends. The risk-free interest rate is based on the U.S. Treasury yield curve rate in effect at grant date with average equivalent term.

The fair value of each option grant is estimated on the date of grant based on the Black-Scholes option pricing model and using the following weighted average assumptions:

	2017	2016
Dividend yield	1.56	--
Expected life	6.2 years	7 years
Risk-free interest rate	2.02%	1.46%
Expected volatility	19.44%	18.63%

The Black-Scholes model used by the Company to calculate option values, as well as other currently accepted option valuation models, were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which differ from the Company's stock option awards. These models require highly subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values.

A summary of the status of the Company's stock option plan as of December 31, 2017, and changes during the years ending on those dates, is presented below:

2017	Shares	Weighted Average Exercise Price	Weighted Average Fair Value At Grant	Intrinsic Value (Dollars in Thousands)
Outstanding at beginning of year	45,650	$30.91	$6.18	$746
Granted	30,000	51.76	9.65	170
Exercised	15,800	33.45	6.69	379
Forfeited	6,000	46.23	11.56	115
Expired	4,500	31.94	5.50	67
Outstanding at end of year	**49,350**	**$40.82**	**$7.53**	**$819**

2017	Shares	Weighted Average Exercise Price	Weighted Average Fair Value At Grant	Intrinsic Value (Dollars in Thousands)
Vested and expected to vest	44,667	$40.82	$7.53	$741
Options exercisable at year end	31,350	$34.05	$6.59	$732

The following information summarizes information about stock options outstanding and exercisable at December 31, 2017:

	Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
$ 15.00 – 25.00	7,850	3.83	$21.93	7,850	3.83	$21.93
$ 25.01 – 40.00	16,500	4.95	$32.23	16,500	4.95	$32.23
$ 40.01 – 50.00	5,000	9.09	$48.45	2,000	9.09	$48.45
$ 50.01 – 58.50	20,000	9.51	$53.41	5,000	9.48	$53.35
Balance at December 31, 2017	49,350	7.04	$40.82	31,350	5.65	$34.05

The total intrinsic value of the options exercised during 2017 and 2016 was $301,000 and $261,000, respectively. Weighted average remaining contractual life of options vested and expected to vest is 7.40 years. Total proceeds from options exercised in 2017 and 2016 were $298,000 and $352,000 respectively. As a result of disqualifying dispositions of options exercised, the Company recorded no tax benefit in 2017 and $10,000 in 2016.

At December 31, 2017, unrecognized compensation expense related to unvested options totaled $142,000 and is expected to be recognized over a weighted average period of thirty-one months. During 2017 9,000 options vested with a weighted average fair value at grant date of $9.63. During 2016 2,300 options vested with a weighted average fair value at grant date of $10.28.

Restricted Stock Plan

Restricted stock awards are generally scheduled to vest over a 3 year period, with the unearned compensation related to restricted stock amortized to expense on a dynamic prorated straight-line basis. Unrecognized compensation cost related to unvested restricted stock awards in 2017 and 2016 totaled $111,000 and $161,000, respectively. Total expense recognized by the Company for restricted stock awards for the year ended December 31, 2017 and 2016 was $139,000 and $101,000, respectively.

The following table summarizes our restricted stock awards activity:

	Shares	Weighted Average Fair Value At Grant
Outstanding as of January 1, 2016	1,430	$36.37
Granted	4,050	40.49
Vested	(2,110)	39.52
Forfeited	(90)	40.00
Outstanding at December 31, 2016	3,280	$39.34
Granted	3,750	$48.45
Vested	(2,600)	44.18
Forfeited	(560)	41.83
Outstanding at December 31, 2017	3,870	$44.55

Scheduled vesting for outstanding restricted stock awards as of December 31, 2017 is as follows:

	Year Ended			
	2018	**2019**	**2020**	**Total**
Scheduled vesting – restricted stock awards	1,760	1,360	750	3,870

Profit-Sharing Plans

The Company has a 401(k) employee benefit plan for those employees who meet eligibility requirements set forth in the plan. Eligible employees may contribute up to 100% of their compensation, subject to certain IRS limits. The Company provides a discretionary match of 100% of the first 4% contributed by participants. Additionally, matching contributions may be made by the Company pursuant to a prescribed formula based on the Company's achievement of certain performance goals. The Company contributed $436,000 and $402,000 in 2017 and 2016, respectively.

Incentive compensation is awarded to certain employees based on the financial performance of the Company. Cash bonuses were awarded pursuant to a formula targeted on the Company achieving certain performance goals for the years ended in 2017 and 2016, with the amounts awarded in 2018 and 2017. Amounts awarded under the plan for 2017 and 2016 were $396,000 and $396,000, respectively.

Deferred Compensation Plan

The Company entered into deferred compensation arrangements with key employees. The agreements provide for employee and Company matching contributions equal to the amount that would have been contributed under the Company's 401(k) plan, had the employees not been otherwise excluded from the plan. At December 31, 2017 and 2016, the Company had a recorded liability in the amount of $2,394,000 and $2,241,000, respectively. The Company contributed $122,000 and $110,000 in 2017 and 2016, respectively, of which $122,000 and $110,000, respectively, represented plan earnings in accordance with the deferred compensation agreements.

Insurance

The Company provides certain health care, disability, and life insurance benefits for current employees. The cost of health care benefits for employees is recognized as expense when paid. Life insurance benefits for employees are provided through an insurance company whose premiums are based on the benefits paid during the year. The Company recognizes the cost of providing such benefits by expensing the monthly insurance premiums. For 2017 and 2016, the cost of providing health care, disability, and life insurance benefits was $1,335,000 and $1,345,000, respectively.

Note 16 - Regulatory Matters

The Company is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines of the regulatory framework for prompt corrective action, the Company must meet specific capital adequacy guidelines that involve quantitative measures of the Company's assets, liabilities, and certain off-balance sheet items, as calculated under regulatory accounting practices. The Company's capital classification is also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company maintain minimum amounts and ratios (set forth in the table below) of Tier 1 capital to total average assets and minimum ratios of Tier 1 and total capital to risk-weighted assets.

In July 2013, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (FDIC) approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III). Under the final rules, which became effective for the Bank on January 1, 2015 and are subject to a phase-in period through January 1, 2019, minimum requirements increased for both the quantity and the quality of capital held by the Bank. The rules include a new Common Equity Tier 1 capital to risk-weighted assets ratio (CET1 ratio) of 4.5% and a capital conservation buffer of 2.5% above the regulatory minimum risk-based capital requirements, which when fully phased in, effectively results in a minimum CET1 ratio of 7.0%. Basel III also (i) raises the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% (which, with the capital conservation buffer, effectively results in a minimum Tier 1 capital to risk-weighted assets ratio of 8.5% when fully phased in); (ii) effectively results in a minimum total capital to risk-weighted assets ratio of 10.5% (with the capital conservation buffer fully phased in); and (iii) requires a minimum leverage ratio of 4.0%. Basel III also makes changes to risk weights for certain assets and off-balance sheet exposures.

As of December 31, 2017, the most recent notification from the Company's regulator categorized the Company as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Company must maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Company's actual capital amounts and ratios are also presented in the following table (dollars in thousands). Management believes as of December 31, 2017, that the Company meets all capital requirements to which it is subject.

December 31, 2017	Actual		Regulatory Minimum to be "Adequately Capitalized"		Basel III Minimum Adequacy with Capital Conservation Buffer		Regulatory Minimum to be "Well Capitalized"	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
Tier 1 leverage (to average assets)	$168,085	11.15%	$60,310	4.00%	N/A	N/A	$75,387	5.00%
CET1 capital (to risk-weighted assets)	168,085	17.71%	42,704	4.50%	$54,566	5.75%	61,684	6.50%
Tier 1 capital (to risk-weighted assets)	168,085	17.71%	56,939	6.00%	68,801	7.25%	75,918	8.00%
Total capital (to risk-weighted assets)	178,959	18.86%	75,918	8.00%	87,781	9.25%	94,898	10.00%

December 31, 2016	Actual		Regulatory Minimum to be "Adequately Capitalized"		Basel III Minimum Adequacy with Capital Conservation Buffer		Regulatory Minimum to be "Well Capitalized"	
	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio	Capital Amount	Ratio
Tier 1 leverage (to average assets)	$157,078	10.92%	$57,549	4.00%	N/A	N/A	$71,936	5.00%
CET 1 capital (to risk-weighted assets)	157,078	17.66%	40,015	4.50%	$45,573	5.13%	57,799	6.50%
Tier 1 capital (to risk-weighted assets)	157,078	17.66%	53,353	6.00%	58,911	6.63%	71,138	8.00%
Total capital (to risk-weighted assets)	168,195	18.91%	71,138	8.00%	76,695	8.63%	88,922	10.00%

Restrictions on Retained Earnings

The Company is restricted from paying dividends in an amount that would decrease regulatory capital below the minimum amounts shown above.

Note 17 - Fair Value

The Company is required to disclose the estimated fair value of financial instruments, both assets and liabilities on and off the balance sheet, for which it is practicable to estimate fair value. These fair value estimates are made at December 31, 2017 based on relevant market information and information about the financial instruments. Fair value estimates are intended to represent the price an asset could be sold at or the price a liability could be settled for. However, given there is no active market or observable market transactions for many of the Company's financial instruments, the Company has made estimates of many of these fair values which are subjective in nature, involve uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimated values.

Fair Value of Financial Instruments

The carrying amounts and estimated fair value of the Company's financial instruments are as follows (dollars in thousands):

		December 31, 2017		December 31, 2016	
	Level	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets					
Cash and cash equivalents	1	$56,686	$56,686	$125,444	$125,444
Securities available for sale	1	3,636	3,636	--	--
Securities available for sale	2	511,212	511,212	414,129	414,129
Securities held to maturity	2	1,539	1,523	1,551	1,533
FHLB and PCBB stock	2	2,069	2,069	1,995	1,995
Loans held for sale	2	1,171	1,195	397	402
Loans and leases, net	3	883,661	882,292	861,019	861,580
Mortgage servicing rights	3	1,696	3,952	1,723	3,892
Accrued interest receivable	2	5,578	5,578	4,504	4,504
Bank Owned Life Insurance	2	14,582	14,582	14,118	14,118
Financial Liabilities					
Deposits	3	$1,314,302	$1,111,242	$1,269,026	$1,086,435
Borrowings	3	11,557	11,784	13,871	14,199
Interest rate swaps	2	278	278	371	371
Accrued interest payable	2	454	454	445	445

The Company assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of the Company's financial instruments will change when interest rate levels change and that change may either be favorable or unfavorable to the Company. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities, and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

The following methods and assumptions were used by the Company in estimating the fair value of financial instruments:

Cash and Due from Banks, Fed Funds Sold and Interest Bearing Deposits at Other Financial Institutions

Cash and due from banks, Fed funds sold, and interest bearing deposits at other financial institutions are valued at their carrying amounts, which are reasonable estimates of fair value due to the relatively short period to maturity of the instruments.

Securities Available for Sale and Held to Maturity

Securities totaling $516,387,000 are reported at fair value utilizing Level 1 and Level 2 inputs for available for sale securities and Level 2 inputs for held to maturity securities. The fair values of securities utilizing Level 2 inputs are based on quoted market prices of similar instruments and dealer quotes or determined utilizing a present value income model that utilized observable market-based inputs, as described in Note 1. The fair values were obtained from an independent pricing service and internally validated. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus, prepayment speeds, credit information, and the bond's terms and conditions, among other things.

Federal Home Loan Bank and Pacific Coast Banker's Bancshares Stock

The carrying value of Federal Home Loan Bank (FHLB) and Pacific Coast Banker's Bancshares (PCBB) stock approximates fair value because the shares can only be redeemed by the FHLB and PCBB, respectively, at par value.

Loans Held for Sale

The fair value of loans held for sale is based on observable current market prices. If quoted market prices are not available, fair value is based on quoted market prices of similar instruments.

Mortgage Servicing Rights

The fair value of mortgage servicing rights is estimated using a discounted cash flow model to arrive at the net present value of expected earnings from the servicing of the loans. Model inputs include prepayment speeds, market interest rates, contractual interest rates on the loans being serviced, the amount of other fee income generated, and other factors. The fair value of mortgage servicing rights is impacted by any changes in these inputs.

Bank Owned Life Insurance

The carrying amount approximates the estimated fair value of these instruments. Fair values of insurance policies owned are based on the insurance contracts' cash surrender values.

Loans and Leases

Fair values of variable rate loans and leases that reprice frequently and have no significant change in credit risk are based on the carrying values. Fair value of fixed rate loans and leases is estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair value of impaired loans and leases is estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposit Liabilities

The fair value of deposits with no stated maturity date is included at the amount payable on demand. The fair value of fixed rate certificates of deposit is estimated using a discounted cash flow calculated based on interest rates currently being offered on similar certificates.

Short-Term Borrowings

The carrying amounts of demand notes issued to U.S. Treasury and repurchase agreements approximate their fair value due to the relatively short period to maturity of the instruments.

Long-Term Borrowings

Fair value of the Company's long-term borrowings is estimated using discounted cash flow analyses based on the Company's current incremental borrowing rate for similar types of borrowing arrangements.

Accrued Interest

Carrying amounts of accrued interest approximate fair value due to their short settlement periods.

Interest Rate Swap Derivatives

The fair values of interest rate swap derivatives are estimated by an independent third-party using a discounted cash flow method based on current incremental rates for similar types of arrangements. For purposes of potential valuation adjustments to its derivative positions, the Company evaluates the credit risk of its counterparties as well as that of the Company. Accordingly, the Company has considered factors such as the likelihood of default by the Company and its counterparties, its net exposures, and remaining contractual life, among other things, in determining if any fair value adjustments related to credit risk are required. Counterparty exposure is evaluated by considering the amounts of collateral securing the position. The Company reviews its counterparty exposure on a regular basis, and when necessary, appropriate business actions would be taken to adjust the exposures. The Company also uses this approach to estimate its own credit risk on derivative liability positions. To date, the Company has not realized any significant losses due to a counterparty's inability to pay any net uncollateralized position. The change in value of derivative assets and derivative liabilities attributable to credit risk was not significant during the reported periods.

Off-Balance Sheet Instruments

The fair value of commitments to extend credit and standby letters of credit was estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the customers. Since the majority of the Company's off-balance sheet instruments consist of non-fee producing, variable rate commitments, the Company has determined they do not have a distinguishable fair value.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents information about the Company's assets measured at fair value on a recurring basis as of December 31, 2017 and 2016, respectively, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (dollars in thousands):

		Fair Value Measurement Using		
December 31, 2017	**Assets/(Liabilities) Total**	**Level 1**	**Level 2**	**Level 3**
State and municipal securities	$263,805	$3,636	$260,169	$--
Collateralized mortgage obligations	175,845	--	175,845	--
Mortgage-backed securities	75,177	--	75,177	--
Money market mutual funds	21	--	21	--
Securities available for sale	$514,848	$3,636	$511,212	
Interest rate swap derivatives	(278)	--	(278)	--
December 31, 2016				
State and municipal securities	$157,545	$--	$157,545	$--
Collateralized mortgage obligations	207,487	--	207,487	--
Mortgage-backed securities	49,078	--	49,078	--
Money market mutual funds	21	--	21	--
Securities available for sale	$414,131	$--	$414,131	$--
Interest rate swap derivatives	(371)	--	(371)	--

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

As of December 31, 2017 and 2016, the Company did not hold any significant assets or liabilities measured at fair value on a nonrecurring basis.

Note 18 – Other Comprehensive Income

Net unrealized gains and losses on available for sale securities reported in other comprehensive income comprised of the following (dollars in thousands):

	Before Tax Amount	Tax Effect	Net of Tax Amount
Year Ended December 31, 2017			
Unrealized holding gains arising during the year	$532	$(186)	$346
Reclassification adjustment for gains realized in net income	(439)	153	(286)
Net unrealized gains/(losses)	$93	$(33)	$60
Year Ended December 31, 2016			
Unrealized holding losses arising during the year	$(7,261)	$2,542	$(4,719)
Reclassification adjustment for losses realized in net income	1,925	(674)	1,251
Net unrealized gains/(losses)	$(5,336)	$1,868	$(3,468)

Note 19 – Shareholders' Equity and Earnings per Common Share

Earnings per Common Share

The following table presents a reconciliation of the number of shares used in the calculation of basic and diluted earnings per common share (dollars in thousands, except share and per share amounts):

	2017	2016
Distributed earnings allocated to common stock	$4,434	$4,004
Undistributed earnings allocated to common stock	13,974	13,520
Net earnings allocated to common stock	$18,408	$17,524
Weighted average common shares outstanding - Basic	4,103,992	4,088,566
Dilutive effect of options outstanding	15,616	15,986
Weighted average common shares outstanding - Diluted	4,119,608	4,104,552
Earnings per common share – Basic	$4.49	$4.29
Earnings per common share – Diluted	$4.47	$4.27
"Out of the money" stock options	--	--

Stock Repurchase Plans

From time to time, the Company's board of directors has authorized stock repurchase plans. In general, stock repurchase plans allow the Company to proactively manage its capital position and return excess capital to shareholders. Shares purchased under such plans also provide the Company with shares of common stock necessary to satisfy obligations related to stock compensation awards. Under the most recent plan, there were no shares repurchased in 2017 and there were 150 shares repurchased in 2016.

Note 20 – Subsequent Events

The Company performed an evaluation of subsequent events through March 14, 2018, the date these financial statements were available to be issued.

On January 16, 2018, the Company's Board of Directors approved a dividend of $0.60 per share, payable on February 5, 2018, to shareholders of record as of January 26, 2018.

On February 1, 2018, the Company opened a new branch in Yakima. Contractual commitments at December 31, 2017 to complete construction of the branch are disclosed in Note 6.

On February 20, 2018, the Company's Board of Directors approved a special dividend of $1.50 per share, payable on March 12, 2018, to shareholders of record as of March 2, 2018.

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Directors and Officers

Board of Directors
Brian Nelson, Chairman
Lyman Boyd, Vice Chairman
Judy Conner, CPA
Bill Dronen
Greg Oakes
John Doyle
Keith Wiggins

Administrative Officers
Greg Oakes, President & Chief Executive Officer
Mike Lundstrom, EVP & Chief Financial Officer
Connie Fritz, EVP & Chief Retail Operations Officer
Steve Vradenburg, EVP & Chief Lending Officer
Sue Ozburn, EVP & Chief Information Officer

Mitchell, Reed & Schmitten Insurance Board of Directors
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Lori Reed
Lyman Boyd
Jim Gibbons
Laura Mounter
Brent Schmitten
Marc Heminger

Finance
DeAnne Williams, VP & Controller

Internal Audit
Dennis Combs, Examiner

Credit Administration
Ann Rankin, AVP & Credit Operations Supervisor
Kyle Bruggman, Credit Administration Assistant

Compliance
Deidra Anderson, VP & Compliance Officer

Retail Operations and Personnel
Jennifer West, AVP & Human Resource Director
Jeff Burton, AVP & Retail Operations Officer

Financial Services Group
Art Hansen, SVP & Financial Services Manager

Contract Purchasing and Equipment Leasing
Chuck Moser, VP & Loan Officer
Chris Ewer, VP & Equipment Leasing Manager
Jeff Miller, AVP & Loan Officer
Jessica Steinburg, Financial Services Supervisor

Electronic Banking and Card Services
Sharon Low, VP & Manager
Nicole Ivarsen, Card Service Plan Manager

Municipal Banking
Ron Olsen, SVP & Manager
Thomas Brown, AVP & Loan Officer

Information Technology
Terri Howard, Information Systems Operations Officer

Cashmere Valley Mortgage
Shirley Reyes, SVP & Mortgage Servicing Manager
Kyle Lewis, SVP & Mortgage Production Manager

Mitchell Reed & Schmitten Insurance
Brent Schmitten, President & Chief Operations Officer

Cashmere Valley Wealth Management
Timothy Meyers, Division Director

Cashmere Branch
Josh Price, AVP & Manager
Jana Flores, Retail Operations Officer

Maple Street, Wenatchee Branch
Steve Lee, SVP & Manager
Christy Tomlinson, AVP & Retail Operations Officer
Mike Kintner, VP & Commercial Lender

Leavenworth Branch
Darrin Rylaarsdam, SVP & Manager
Shawna Alexander, AVP & Retail Operations Officer
Gary Waunch, Loan Officer

East Wenatchee Branch
Alex Cruz, VP & Manager
Ann Kinzel, AVP & Retail Operations Officer

Chelan Street, Wenatchee Branch
Jenny Pulver, VP & Manager

Easy Street, Wenatchee Branch
Claudia De Robles, VP & Manager
Elizabeth Mejia, Retail Operations Officer

Ellensburg Branch
Pam Wilson, VP & Manager
Miriam Nation, Retail Operations Officer
Kimberly Bonjorni, Loan Officer

Cle Elum Branch
Dale Loveland, SVP & Manager
Caren Reed, Retail Operations Officer

Lake Chelan Branch
Russ Jones, VP & Manager
Jan Fryer, Retail Operations Officer

Summitview Avenue, Yakima Branch
Maria Fabara, Retail Operations Officer

Yakima Avenue, Yakima Branch
Taylor Stormo, VP & Manager
Brittanie Vaughn, Retail Operations Officer

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East Wenatchee Branch
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Cashmere Valley Mortgage
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Electronic Banking
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509-664-5454

Valley Contract Servicing
124 East Penny Road, Suite 205, Wenatchee
509-664-5452

Card Services
124 East Penny Road, Suite 106, Wenatchee
Credit Cards 509-664-5455
ATM/Debit Cards 509-664-5453

Dealer Financing
124 East Penny Road, Suite 201, Wenatchee
509-664-3820

Equipment Finance Solutions
124 East Penny Road, Suite 202, Wenatchee
509-665-1088

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Ellensburg Office
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509-962-0902

Yakima Office
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509-454-5156

Elliott Insurance Service
127 West Yakima Avenue, Suite 201, Yakima
509-248-7711

Leavenworth Office
980 Highway 2, Leavenworth
509-548-6050

Cle Elum Office
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